Supreme Court, U.S.
FILED

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No. _____

**IN THE SUPREME COURT OF THE UNITED STATES**

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**HCMF CORP., HERITAGE HALL HOLDING LIMITED PARTNERSHIP, HERITAGE HALL XIII PARTNERSHIP, HCMF PARTNERSHIP VI, HCMF VI ADDITION LIMITED PARTNERSHIP, and HCMF XV PARTNERSHIP,**

***Petitioners,***

**v.**

**CLAUDE A. ALLEN, Secretary of Health and Human Resources; ROBERT W. LAUTERBERG, Director of the Department of Medical Assistance Services, Commonwealth of Virginia; H. ALAN BIGLEY, JR.; DANIEL M. BRODY; LA TISHA OWENS CHATMAN; CATHERINE C. COLGAN; DENICE KING GARNER; STEVEN L. MINTER; JAMES T. PARMALEE, CATHERINE P. SAUNDERS, JAMES R. SMITH; JAMES L. MASLOFF,**

***Respondents,***

**and**

**JAMES GILMORE, The Governor of the Commonwealth of Virginia; THE DEPARTMENT OF MEDICAL ASSISTANCE SERVICES; FRANK MEDICO,**

***Defendants.***

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**ON PETITION FOR A WRIT OF *CERTIORARI* TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT**

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# PETITION FOR WRIT OF *CERTIORARI*

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## QUESTIONS PRESENTED

1. Whether this Court should grant a writ of *certiorari* to resolve a conflict among the United States courts of appeals concerning the enforceability under 42 U.S.C. § 1983 of the federal standard for reimbursing Medicaid providers in states that have not adopted rates pursuant to the public process provisions of the Balanced Budget Act of 1997, § 4711, Pub. L. No. 105-33, 111 Stat. 251, 507-08?

2. Whether this Court should grant a writ of *certiorari* to resolve a conflict among the United States courts of appeals determining whether federal rights that are actionable under 42 U.S.C. § 1983 are limited to those created by the U.S. Constitution or directly by statute without reference to agency regulation, interpretation or policy?

3. Whether this Court should grant a writ of *certiorari* in light of the important questions of federal law set forth herein that have not been, but should be settled, by this Court?

## CORPORATE DISCLOSURE STATEMENT

Pursuant to Sup. Ct. R. 14.1(b) & 29.6, Petitioners HCMF Corp., Heritage Hall Holding Limited Partnership, Heritage Hall XIII Partnership, HCMF Partnership VI, HCMF VI Addition Limited Partnership, and HCMF XV Partnership disclose that they have no parent corporation and that there is no publicly held company that owns 10% or more of their stock.

. Heritage Hall Holding, LLC; Mountain View Inns, LLC; Heritage Hall III, LLC; Leesburg-Loudoun, LLC; HCMF VI, LLC; HCMF XII, LLC; and American HealthCare X, LLC hereby disclose that they are interested in the subject matter of this litigation as the successors in interest to the entities listed above. There is no publicly held company that owns 10% or more of the stock of these successors in interest, and American HealthCare X, LLC hereby discloses that its parent corporation (with 100% ownership interest) is American HealthCare LLC.

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**Petitioners HCMF Corp., Heritage Hall Holding Limited Partnership, Heritage Hall XIII Partnership, HCMF Partnership VI, HCMF VI Addition Limited Partnership, and HCMF XV Partnership [collectively "HCMF"] respectfully request that this Court issue a writ of *certiorari* to review the panel decision of the United States Court of Appeals for the Fourth Circuit; reverse that decision; and remand this case for further proceedings in light of the questions of federal law that are raised and preliminarily discussed herein.**

## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fourth Circuit is published as HCMF Corp. v. Allen, 238 F.3d 273 (4th Cir. 2001), and is contained in the Appendix at A-15 through A-22.

The opinion and order of the United States District Court for the Western District of Virginia denying HCMF's Motion to Amend Complaint for Declaratory Relief and for Permanent Injunction is published as HCMF Corp. v. Allen, 85 F. Supp. 2d 643 (W.D. Va. 2000), *aff'd*, 238 F.3d 273 (4th Cir. 2001), and is contained in the Appendix at A-1 through A-14.

The opinion of the United States District Court for the Western District of Virginia denying Defendants' Motion to Dismiss on ripeness grounds, denying Defendants' request to abstain in this matter, dismissing Counts I-III of HCMF's Complaint for Declaratory Relief and for Permanent Injunction ["Complaint"], and asking for briefs on Count IV, is published as HCMF Corp. v. Gilmore, 26 F. Supp. 2d 873 (W.D. Va. 1998).

## STATEMENT OF JURISDICTION

The judgment of the United States Court of Appeals for the Fourth Circuit was entered on January 23, 2001. This Petition for Writ of *Certiorari* is timely filed within 90 days from that date. Sup. Ct. R. 13.3. This Court has jurisdiction to review the final judgment of the court of appeals on a writ of *certiorari* pursuant to 28 U.S.C. § 1254(1).

## STATUTORY AND REGULATORY PROVISIONS INVOLVED

42 U.S.C. § 1983 ("Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory or the District of Columbia, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress . . . .");

42 U.S.C. § 1396a(a)(13)(A) (1997) ["the Boren Amendment"], *repealed by* Balanced Budget Act of 1997, § 4711, Pub. L. No. 105-33, 111 Stat. 251, 507-08 ("A State plan for medical assistance must . . . . provide . . . . for lower reimbursement rates reflecting the level of care actually received . . . which the State finds, and makes assurances satisfactory to the Secretary, are reasonable and adequate to meet the costs which must be incurred by efficiently and economically operated facilities in order to provide care and services in conformity with applicable State and Federal laws, regulations, and quality and safety standards . . . .");

42 U.S.C. § 1396a(a)(13)(A) (2001) ("A State plan for medical assistance must . . . . provide — for a public process for determination of rates of payment under the plan

for hospital services, nursing facility services, and services of intermediate care facilities for the mentally retarded under which — (i) proposed rates, the methodologies underlying the establishment of such rates, and justifications for the proposed rates are published, (ii) providers, beneficiaries and their representatives, and other concerned State residents are given a reasonable opportunity for review and comment on the proposed rates, methodologies, and justifications, [and] (iii) final rates, the methodologies underlying the establishment of such rates, and justifications for such final rates are published . . . .").

Letter from Sally K. Richardson, Director, Center for Medicaid and State Operations, Health Care Financing Administration, to State Medicaid Directors (Dec. 10, 1997) (contained in the Appendix at A-23 to A-25).

## STATEMENT OF THE CASE

As this Court held in Wilder v. Virginia Hosp. Ass'n, 496 U.S. 498 (1990), the so-called Boren Amendment, formerly appearing at 42 U.S.C. § 1396a(a)(13)(A), guaranteed Medicaid providers a federal right, enforceable under 42 U.S.C. § 1983, to receive reasonable and adequate reimbursement. In the Balanced Budget Act of 1997, the right of reimbursement was changed to be whatever a state chose to adopt pursuant to a public process of notice and comment. For states like Virginia that did not change their reimbursement standards through such a public process, the Health Care Financing Administration ["HCFA"], as the administering agency, has provided written guidance that such states are to discharge their reimbursement obligation through continued adherence to the previously adopted Boren Amendment standard. HCMF contends that its reimbursed costs are unreasonable and inadequate – a merits issue never reached below – and that the Medicaid Act as administered by the HCFA continues to create sufficiently

concrete federal rights so as to be enforceable under 42 U.S.C. § 1983.

HCMF built seven nursing facilities in Virginia in the late 1970s and 1980s under certificates of public need that it obtained from the Virginia State Health Commissioner who, at that time, also administered Virginia's State Plan for Medical Assistance Services under the Medicaid Program ["the State Plan"]. (Joint Appendix "J.A." at 25.) HCMF financed these seven facilities through mortgages insured by the Federal Housing Authority of the United States Department of Housing ["FHA"] and through Urban Development and tax-exempt Industrial Development Bonds authorized by the Industrial Development Authorities ["IDAs"] in the localities where they were built. (J.A. 26, 147.)

Under the terms of the bond indentures, commercial banks acted as the bond trustees and assumed the duty of collecting monthly mortgage payments from HCMF and depositing them into bond funds created by these indentures. (J.A. 28, 147.) HCMF granted first lien mortgages to the bond trustees, buying mortgage insurance from the FHA and then endorsing the mortgages so that the bond trustees were the beneficiaries of the mortgage insurance. (J.A. 29, 147.)

Under this financing structure, HCMF was obligated to pay interest, and thereby incur reimbursable plant costs, but only on the FHA-insured mortgages, which had slightly higher rates of interest than the IDA bonds. (J.A. 29-30.) It was possible that the bond trustees might pay off the bonds prior to their maturity dates, resulting in a savings on total interest payments over the terms of the bonds. (J.A. 30.) Because HCMF had obtained these mortgages as security for the bonds, it believed it had secured a lower mortgage interest rate than it would have obtained had it financed these

facilities solely through FHA-insured mortgages or through unrated bonds. (J.A. 31-32.)

Before executing its financing agreements, including the FHA-insured mortgages, HCMF discussed this financing structure with the state agencies charged with administering the State Plan – the Department of Health and its successor, the Department of Medical Assistance Services ["DMAS"]. (J.A. 34.) DMAS began reimbursing HCMF at its mortgage rate of interest on February 2, 1981. (*Id.*)

On September 18, 1986, an officer at an investment banking firm that anticipated purchasing the IDA bonds for the HCMF facility in Albemarle County, wrote to DMAS to verify that DMAS would reimburse plant costs at the interest rate on the FHA-insured mortgages. (J.A. 34, 43.) The Director of DMAS' Division of Provider Reimbursement responded that DMAS would reimburse HCMF at the mortgage interest rate so long as that rate fell below the Medicaid interest cap, which it did. (J.A. 34, 44, 48-49.) During the 1980s, HCMF continued to seek reimbursement for its plant costs at its mortgage rate of interest, and DMAS reimbursed it at that mortgage rate after auditing HCMF's submissions. (*See generally* J.A. 34-35.)

During his Rule 30(b)(6) deposition, James Branham, a DMAS employee, stated that that because the hypothetical early payoff of the bonds could lead to an early discharge of the FHA-insured mortgages, he determined in 1990 that HCMF was only entitled to reimbursement at its lower bond rate of interest because this hypothetical payoff would cause some payments listed as "interest" on HCMF's amortization schedules to become "principal." (J.A. 387, 481-85, 487-88, 493, 496-99, 521-22, 528-29.) Based on this theory, DMAS began to reimburse HCMF's plant costs under the State Plan at HCMF's lower bond interest rate. (J.A. 35, 514.) This unilateral change in reimbursement policy was not

predicated upon any change in federal or state law or regulations. As a consequence of the change, HCMF incurred continual operating shortfalls because it was still legally obligated to pay monthly interest charges to the bond trustees at the higher mortgage rate of interest. (J.A. 493-94.) This ultimately led HCMF to file a Complaint in the United States District Court for the Western District of Virginia, Roanoke Division, on May 8, 1998, charging that its rates of reimbursement are inadequate and unreasonable. (J.A. at 17-44.)

In Count I of its Complaint, HCMF claimed that Defendants violated 42 U.S.C. § 1983, the reimbursement standard dictated by the Boren Amendment, and 42 C.F.R. § 447.253 (one of the implementing regulations under the Boren Amendment)[1] by acting under color of state law to deny HCMF's federal right to reimbursement at a rate that was "reasonable and adequate to meet the costs which must be incurred by efficiently and economically operated facilities." (J.A. 36-37) (quoting 42 U.S.C. § 1396a(a)(13)(A) (1997)). While HCMF recognized that the Boren Amendment had been repealed at 111 Stat. 251, 507-08 (1997), it asserted that existing liabilities were preserved by 1 U.S.C. § 109. (J.A. 23.)

Defendants moved to dismiss HCMF's Complaint in its entirety and to stay all discovery pending the resolution of that motion. (J.A. 45-103.) In an order dated November 9, 1998, the district court dismissed Counts I and II of HCMF's Complaint.[2] (J.A. 126-33.) The district court also entered

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[1] In Counts II and III, HCMF alleged *inter alia* that Defendants had also violated 42 C.F.R. §§ 447.205, -250, -.253, & -.256. (J.A. 38-39.)

[2] The district court dismissed Count I because of its view that "[w]ith the repeal of the Boren Amendment nothing remains that remotely resembles a federal right to reasonable and adequate rates. There is no federal statutory rate language to parse. There is only a state standard." HCMF, 26 F. Supp. 2d at 880 (internal footnote omitted). It dismissed Count II

judgment for Defendants on Count III (asserting Due Process violations) and reserved judgment on Count IV, allowing the parties to brief this claim on its merits. (J.A. 133-35.)

Both sides moved for summary judgment on Count IV of the Complaint. (J.A. 152-208.) While these cross-motions were pending, HCMF moved for leave to amend its Complaint and add Count V because in Children's Hosp. and Health Ctr. v. Belshe, 188 F.3d 1090 (9th Cir. 1999), *cert. denied*, 530 U.S. 1204 (2000), the Ninth Circuit had held that the Boren Amendment continues to create actionable federal rights in states that did not amend their reimbursement plans. (J.A. 209-38.)

In its final order dated February 29, 2000, the district court (1) reconfirmed its dismissal of Counts I and II and its entry of judgment for Defendants on Count III, (2) granted Defendants' Motion for Summary Judgment on Count IV, (3) denied HCMF's Motion to Amend to add Count V, and (4) struck the case from its docket. (J.A. 653-64.) The district court denied HCMF's Motion to Amend because it deemed Count V to be a mere reassertion of Count I.[3] HCMF, 85 F. Supp. 2d at 646.

On appeal, HCMF contended in relevant part that the district court had abused its discretion in denying its Motion to Amend to assert Count V, which incorporated into this

(footnote 2 cont'd) because it viewed that claim as "nothing more than a dispute about whether DMAS has properly applied or is properly applying [the State Plan]." *Id.* at 881.

[3] Specifically, the district court held that "[HCMF] ignore[d] the fact that the court has already ruled on this question of law and found that no such claim exists." HCMF, 85 F. Supp. 2d at 646 (citation omitted). It thus reasoned that "HCMF's motion to amend does not assert any new legal theory and, therefore, is futile," and declared that "[i]f the Ninth Circuit has held to the contrary, HCMF should take that up in an appeal, not in a motion to amend." *Id.* (internal footnote in latter quotation omitted).

case the claim on which the plaintiffs in Belshe (who were similarly-situated to HCMF) had prevailed. (Br. Appellants at 17-26.)

In its decision dated January 23, 2001, a panel of the Fourth Circuit held that the district court erred when denying HCMF's Motion to Amend on futility grounds for failure to state a new claim. The panel stated in relevant part that it

> agree[d] with HCMF's contention that the proposed amendment set forth a new legal theory. HCMF originally claimed that it had a federal right under the Boren Amendment itself for DMAS to pay reasonable and adequate rates of reimbursement. In the proposed amendment, HCMF sought to assert that HCFA's letter created a federal right to reasonable and adequate rates of reimbursement. Although both of these claims sought enforcement of the 'reasonable and adequate' standard located in the Boren Amendment, the legal theory in the motion to amend was distinct – that a federal policy, rather than a federal statute, created a federal right. Accordingly, the district court was incorrect to consider the amendment merely a restatement of the original claim.

HCMF, 238 F.3d at 277 (citation omitted).

The panel also accepted that "[i]n Belshe, the Ninth Circuit held that HCFA's letter authorizes the continued application of the Boren Amendment, and implicitly concluded that private parties may enforce the HCFA letter in a § 1983 action." *Id.* (citation omitted). Nevertheless, it "respectfully disagree[d] with the latter conclusion" and held that HCFA's letter had no bearing on this case. *Id.*

Because the Fourth Circuit had previously ruled that "a formal regulation cannot by itself give rise to a federal right enforceable under § 1983," *id.* (citing Smith v. Kirk, 821 F.2d 980, 984 (4th Cir. 1987)), the panel concluded that the HCFA letter conferred no enforceable rights, although it did recognize that the courts of appeal were divided over this issue. *Id.* (citing King v. Town of Hempstead, 161 F.3d 112, 115 (2d Cir. 1998) (*per curiam*)). It then affirmed the denial of HCMF's motion for leave to amend to add Count V as futile because Count V was "not cognizable regardless of whether the HCFA letter properly authorizes the application of Boren Amendment standards to the payments at issue here." *Id.*

## ARGUMENT

**I. This Court should review the panel decision below on a writ of *certiorari* to resolve a conflict among the United States courts of appeals regarding the applicable standard for reimbursing Medicaid providers like HCMF after the repeal of the Boren Amendment.**

While this case was pending before the district court, the United States Court of Appeals for the Ninth Circuit held that the Boren Amendment continues in effect and confers federal rights on Medicaid providers in states, like Virginia, that have not implemented any new post-Boren rule.[4] Belshe, 188 F.3d at 1099. Applying this rationale, HCMF moved for leave to file an Amended Complaint presenting a new Count V consistent with the decision in Belshe. (J.A. 209-49.)

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[4] Defendants conceded on appeal that reimbursement standards under the State Plan did not change following the repeal of the Boren Amendment. (Br. Appellees at 28) (asserting that "it was not necessary to create such a [public process] requirement").

In Belshe, eighteen hospitals sued the Director of the California Department of Health Services (the state agency charged with administering California's Medicaid Program), contending that the Department's procedures for reimbursing out-of-state Medicaid providers treating California Medicaid patients violated the Boren Amendment. Belshe, 188 F.3d at 1092. The Director moved for summary judgment. *Id.* The district court denied this motion in an order, dated January 9, 1997. *Id.* at 1092, 1094.

Congress subsequently enacted the Balanced Budget Act of 1997, which repealed the Boren Amendment effective October 1, 1997, and replaced it with a new section requiring that states adopt a "public process" for determining Medicaid reimbursement rates. Belshe, 188 F.3d at 1094 (citing § 4711, Pub. L. No. 105-33, 111 Stat. 251, 507-08 (1997)).

On February 4, 1998, the district court issued another order holding that the agency's reimbursement methodology for out-of-state health care providers had violated the Boren Amendment.[5] *See id.* Because the application of the Boren Amendment "involved a 'controlling question of law as to which there may be substantial ground for difference of opinion,'" it certified the question for interlocutory appeal to the Ninth Circuit. Belshe, 188 F.3d at 1095.

On appeal, the Director argued that the Congressional repeal of the Boren Amendment had effectively mooted the action. *Id.* The Ninth Circuit disagreed, noting that after the

> Boren Amendment was repealed, HCFA advised its regional offices and the states

[5] "In essence, the district court held that until the CHDS developed new rates for payment pursuant to the 'public process' provisions of the Balanced Budget Act of 1997, the CHDS had to comply with the Boren Amendment." Belshe, 188 F.3d at 1094.

> participating in the Medicaid program that compliance with the new public process requirements . . . would be waived for payment methodologies that had been validly determined under the Boren Amendment.

*Id.* (citation omitted). Specifically, Sally K. Richardson, the Director of the Center for Medicaid and State Operations at HCFA, had sent a letter to State Medicaid Directors in which she noted in relevant part the following:

> The intent of Section 4711 [of the Balanced Budget Act of 1997] is to provide states with maximum possible flexibility . . . .
>
> * * *
>
> States that are not proposing changes in their payment methods and standards, or changes in rates for items and services furnished on or after October 1, 1997, need not immediately implement a BBA [Balanced Budget Act] public process. States need only publish proposed rates, methodologies, and justifications prior to the proposed effective date of any changes in payment rates or payment methodologies. In other words, states are not required to subject their existing rates to a public process to the extent that those existing rates were validly determined in accordance with legal standards in effect prior to October 1, 1997.

(J.A. 239-40) (reprinted in the Appendix at A-23 to A-24).

The Ninth Circuit held that HCFA's letter effectively "authorized states to continue to use payment methodologies

[that were] approved under the Boren Amendment standard notwithstanding its repeal." Belshe, 188 F.3d at 1095. Thus, the agency could "compl[y] with the Boren Amendment or with the public process provisions of the Balanced Budget Amendment of 1997. It does not have the option of failing to comply with either law. So long as it fails to comply with the Balanced Budget Amendment, it is bound by the Boren Amendment . . . ." *Id.* at 1099.

Because the agency "continues to administer its . . . program by using the Boren Amendment payment methodology," Belshe, 188 F.3d at 1095, the Ninth Circuit held that the Boren Amendment continued to confer enforceable federal rights on health care providers participating in California's Medicaid Program. *Id.* at 1099. Judge Sneed agreed, but dissented because he viewed California's rates as inapposite to the out-of-state plaintiffs. *Id. at* 1099-1101 (Sneed, J., dissenting).

The parallels between this case and Belshe are patent and striking. Like the Director in Belshe, Defendants argued that the repeal of the Boren Amendment rendered HCMF's challenge moot. (*See* Br. Appellee at 24.) Hence, they argued that HCMF's motion for leave to amend its Complaint by adding Count V was clearly futile because it merely "restated the legal theory previously asserted in Count I," which had been dismissed. (*Id.* at 21.)

The Fourth Circuit rejected their position in part and held that Count V stated "a new legal theory" different from that set forth in Count I. HCMF, 238 F.3d at 277. Whereas Count I claimed that HCMF had a federal right to reasonable and adequate reimbursement under the Boren Amendment, Count V relied on the HCFA letter discussed in Belshe as the

source of that federal right.[6] *Id.* However, the Fourth Circuit also held that "HCFA's letter does not have the effect HCMF desires" and rejected the Ninth Circuit's holding in Belshe. This decision widened a split among the United States courts of appeals regarding the continued vitality of the Boren Amendment standard in the post-Boren era.[7]

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[6] Count V stated in relevant part that

> [d]espite Congressional repeal in 1997, the Boren Amendment continues to control issues regarding Medicaid reimbursement rates for nursing facilities in Virginia because Defendants have never imposed new rates pursuant to the current public process standard. The HCFA notified Defendants that they could continue to apply Boran [sic] Amendment standards in lieu of adopting public process standards. This federal policy creates federal rights enforceable pursuant to 42 U.S.C. 1983.
>
> Despite the fact that these same Boren Amendment guidelines still apply, Defendants now reimburse HCMF at rates that are not reasonable or adequate because they do not meet HCMF's actual interest costs in an amount that an efficiently and economically operated facility would incur.

(J.A. 237.)

[7] Defendants had apprised the Fourth Circuit of the "split of authority among the Circuit Courts, as to the enforceability of the repealed Boren Amendment . . . ." (Br. Appellees at 23) (footnote omitted) (noting that the Third Circuit after Belshe had concluded that the Boren Amendment reimbursement standard no longer applied) (citing Children's Seashore House v. Waldman, 197 F.3d 654, 659 (3d Cir. 1999), *cert. denied sub nom.* Children's Seashore House v. Guld, 120 S. Ct. 2742 (2000)). The Second Circuit's ruling in Campbell Hall v. Sullivan, Nos. 97-7632(L) & 97-7642(XAP), 1997 U.S. App. LEXIS 28783, at *4-*5 (2d Cir. Oct. 15, 1997), is also contrary to Belshe, although it did not really address the central issue because the parties there agreed that the repeal of the Boren Amendment mooted that appeal. Nevertheless, as the Eleventh Circuit recently noted, the continued effect of the Boren Amendment remains in dispute among the United States courts of appeals. Florida Ass'n of Rehabilitation Facilities, Inc. v. State of Fla. Agency for Health Care

Because this Court has traditionally granted writs of *certiorari* to resolve splits among the United States courts of appeals, it should grant HCMF's petition for writ of *certiorari* to resolve the open conflict presented here involving the standard for reimbursing health care providers participating in the Medicaid program.

## II. This Court should review the panel decision below on a writ of *certiorari* to resolve a conflict among the United States courts of appeals involving the enforcement of federal rights through 42 U.S.C. § 1983 that arise from sources other than the U.S. Constitution and express statutory provisions.

Although Count V articulated a new theory of relief, the Fourth Circuit nevertheless deemed it futile because prior circuit precedent dictated that "a formal regulation cannot by itself give rise to a federal right enforceable under § 1983." HCMF, 238 F.3d at 277 (citing Smith, 821 F.2d at 984). Relying on Smith, the panel refused to give any weight to the HCFA letter that was upheld in Belshe because "[a] policy letter has even less legal stature than a regulation." HCMF, 238 F.3d at 277. However, it should be noted that other United States courts of appeals have relied on such documents when sustaining causes of action under § 1983. *See, e.g.*, Marie O. v. Edgar, 131 F.3d 610, 620 & n.18 (7th Cir. 1997). In holding as it did, the panel expressly noted that the circuits are split on the question of whether a regulation can create federal rights enforceable under 42 U.S.C. § 1983. *Id.* (citing King, 161 F.3d at 115 (recognizing a split between the Fourth and Sixth Circuits on

(footnote 2 cont'd) Admin., 225 F.3d 1208, 1218 n.9 (11th Cir. 2000) (citing cases on both sides of this dispute without deciding the issue).

this issue)). This is not the first occasion in which a panel of the Fourth Circuit has had occasion to remark on the conflict between Smith and a decision by another court of appeals. Former Special Project Employees Ass'n v. City of Norfolk, 909 F.2d 89, 94 (4th Cir. 1990) (recognizing the same conflict between Smith and Members of the Bridgeport Hous. Auth. Police Force v. City of Bridgeport, 646 F.2d 55 (2d Cir.), *cert. denied*, 454 U.S. 897 (1981)).

This split among the United States court of appeals stems from this Court's 5-4 decision in Wright v. City of Roanoke Redevelopment and Hous. Auth., 479 U.S. 418 (1987). In Wright, tenants argued that the owner of a housing project had violated 42 U.S.C. § 1983 by overcharging them for utilities and thereby exceeding the rent ceiling set by the Brooke Amendment to the Housing Act of 1937. Wright, 479 U.S. at 419. The Fourth Circuit affirmed the district court's finding that the tenants had failed to state a cause of action under § 1983, *id.*, but noted that its decision conflicted with the Second Circuit's opinion in Beckham v. New York City Hous. Auth., 755 F.2d 1074 (2d Cir. 1985). *Id.* at 421 & n.6.

This Court observed that regulations passed under the Brooke Amendment not only defined the term "rent" in great detail, but also showed how the federal agency charged with overseeing those regulations had "treated 'rent' to include a reasonable amount of utility usage." Wright, 479 U.S. at 420 n.3. Although the owner contended that this treatment was too vague to confer any enforceable rights under § 1983, this Court held that the "regulations . . . defining the statutory concept of 'rent' as including utilities, have the force of law" and were "sufficiently specific and definite" to support a § 1983 action. *Id.* at 431 (citation omitted).

However, the dissenting justices showed considerable unease regarding the lasting effect of the majority's opinion.

Justice O'Connor expressed these apprehensions on behalf of the dissenters in dicta as follows:

> In the absence of any indication in the language, legislative history, or administrative interpretation of the Brooke Amendment that Congress intended to create an enforceable right to utilities, it is necessary to ask whether administrative regulations *alone* could create such a right. This is a troubling issue not briefed by the parties, and I do not attempt to resolve it here. The Court's questionable reasoning . . . apparently allows it to sidestep the question. I am concerned, however, that lurking behind the Court's analysis may be the view that, once it has been found that a statute creates some enforceable right, *any* regulation adopted within the purview of the statute creates rights enforceable in federal courts, regardless of whether Congress or the promulgating agency ever contemplated such a result. Thus, HUD's frequently changing views on how best to administer the provision of utilities to public housing tenants becomes the focal point for the creation and extinguishment of federal 'rights.' Such a result, where determination of § 1983 'rights' has been unleashed from any connection to congressional intent, is troubling indeed.

Wright, 479 U.S. at 437-38 (O'Connor, J., dissenting) (emphasis in original).

Since the decision in Wright issued, the United States courts of appeals have relied upon both the dissent and the

majority opinion in Wright to reach opposite conclusions on the ability of federal regulations to create federal rights that are enforceable under § 1983.

On one side of this conflict, the United States Courts of Appeals for the Third, Sixth, and District of Columbia Circuits have held that federal regulations can create federal rights that are cognizable under § 1983.[8] *See, e.g.*, West Va. Univ. Hosps., Inc. v. Casey, 885 F.2d 11, 16 (3d Cir. 1989), *aff'd on other grounds*, 499 U.S. 83 (1991);[9] ("[V]alid federal regulations as well as federal statutes may create rights enforceable under section 1983.") (citing *inter alia* Wright, 479 U.S. at 431-32); Loschiavo v. City of Dearborn, 33 F.3d 548, 551 (6th Cir. 1994), *cert. denied*, 513 U.S. 1150 (1995) ("As federal regulations have the force of law, they likewise may create enforceable rights [under § 1983].") (citing Wright, 479 U.S. at 431); Samuels v. District of Columbia, 770 F.2d 184, 199 (D.C. Cir. 1985) (noting that "section 1983 provides a legal remedy for the violation of all valid federal laws, including at least those federal regulations adopted pursuant to a clear congressional mandate that have the full force and effect of law"). Moreover, the Tenth Circuit has also recognized that "[i]n at least some instances, violations of rights provided under federal regulations

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[8] The Eleventh Circuit further noted in Harris v. James, 127 F.3d 993, 1007 n.18 (11th Cir. 1997), that the First, Eighth, and Ninth Circuits have allowed § 1983 lawsuits "relying at least in part on a regulation" to proceed. (citing Albiston v. Maine Comm'r of Human Servs., 7 F.3d 258 (1st Cir. 1993); Howe v. Ellenbecker, 8 F.3d 1258 (8th Cir. 1993), *cert. denied*, 511 U.S. 1005 (1994); Buckley v. City of Redding, 66 F.3d 188 (9th Cir. 1995)) (all citing *inter alia* Wright).

[9] Congress legislatively overrode this Court's decision in Casey when it enacted the 1991 Civil Rights Act. *See* Joyner v. Monier Roof Tile, Inc., 784 F. Supp. 872, 876 n.13 (S.D. Fla. 1992). However, the underlying decision by the Third Circuit continues to be cited by other federal courts for the proposition that "federal regulations may provide the basis for a § 1983 suit." *See, e.g.*, Value Behavioral Health, Inc. v. Ohio Dep't of Mental Health, 966 F. Supp. 557, 568 (S.D. Ohio 1997).

provide a basis for § 1983 suits." DeVargas v. Mason & Hanger-Silas Mason Co., 844 F.2d 714, 724 (10th Cir. 1988) (citing Wright and Samuels).

In contrast, the United States Courts of Appeals for the Fourth and Eleventh Circuits have unmistakably declared that regulations cannot foster a § 1983 suit. *See, e.g.*, Smith, 821 F.2d at 984 ("An administrative regulation . . . cannot create an enforceable § 1983 interest not already implicit in the enforcing statute. The Supreme Court has never held that one could – to the contrary, members of the Court have expressed doubt that 'administrative regulations *alone* could create such a right.'") (citing Wright, 497 U.S. at 437 (O'Connor, J., dissenting) (emphasis in original));[10] Harris v. James, 127 F.3d 993, 1006 (11th Cir. 1997) (holding that the majority opinion in Wright "remains binding upon us", but did "not foreclose arguments that turn on the concerns expressed [in that case] by the dissent"). The Fifth Circuit has also expressed similar concerns. Gracia v. Brownsville Hous., No. 94-60449, 1997 U.S. App. LEXIS 12981, at *12 (5th Cir. Feb. 14), *cert. denied sub nom.* Gracia v. Trevino, 522 U.S. 865 (1997) ("[I]t is not clear that regulations can be considered 'laws' for purposes of creating a right actionable under section 1983.") (citing Wright, 479 U.S. at 437-39 (O'Connor, J., dissenting)). Other federal courts have noted this division of authorities without deciding the issue. *See, e.g.*, King, 161 F.3d at 115 (2d Cir.).

This Court's recent preemption jurisprudence demonstrates that the Fourth Circuit's reading of Wright has become untenable. In Geier v. American Honda Motor Co., 529 U.S. 861 (2000), this court found conflict preemption

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[10] *See also* Ritter v. Cecil County Office of Hous. and Community Dev., 33 F.3d 323, 327 n.3 (4th Cir. 1994) ("Rights created by regulation alone, if rights can be so created, probably cannot form the basis for a § 1983 action.") (citing Wright, 479 U.S. at 437-38) (O'Connor, J., dissenting)).

where a federal policy conflicted with state common law. If the policy of an agency acting within its authority is 'law' for purposes of the Supremacy Clause, there is no reason why federal policy should not create federal rights for purposes of 42 U.S.C. § 1983 if those rights are sufficiently concrete to satisfy the justiciability test set forth in Wilder.

Support for this position is also found under this Court's treatment of agency interpretation under the Chevron doctrine. As Justice Scalia noted in his concurrence in Christensen v. Harris County, 529 U.S. 576, 590 (2000),

> "'[t]he power of an administrative agency to administer a congressionally created . . . program necessarily requires the formulation of a policy and the making of rules to fill any gap left, implicitly or explicitly by Congress.'" Quite appropriately, therefore, we have accorded Chevron deference not only to agency regulations, but to authoritative agency positions set forth in a variety of other formats.

(quoting Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 843 (1984) (citation omitted)). If HCFA's interpretation of the reimbursement obligation would be entitled to deference, which it would, there is no reason why the resulting rights should not be enforceable under 42 U.S.C. § 1983 if they satisfy the Wilder justiciability test, something the Boren Amendment standard was held to do in Wilder itself.

Because this Court has traditionally granted writs of *certiorari* to resolve splits among the United States courts of appeals, it should grant HCMF's petition for writ of *certiorari* to resolve this conflict arising from the Fourth

Circuit's reliance on Smith to deny HCMF leave to amend its Complaint to add Count V.

## III. This Court should review the panel decision below on a writ of *certiorari* to decide important questions of federal law that should be settled by this Court.

When this Court discussed its grant of a writ of *certiorari* in Wilder, it did not identify any split among the circuits. Wilder, 496 U.S. at 505 & n.5. This suggests that the granting of the writ was predicated on the public importance of the issue presented. The importance of a correct interpretation of Medicaid reimbursement rights has not lessened in the intervening decade, and this Court should grant a writ to resolve this important issue here, particularly as a split in the circuits has now appeared.

## CONCLUSION

WHEREFORE this Petition should be granted, the decision below reversed, and the case remanded for further proceedings on the merits.

Respectfully Submitted,

HCMF CORP., HERITAGE HALL HOLDING LIMITED PARTNERSHIP, HERITAGE HALL XIII PARTNERSHIP, HCMF PARTNERSHIP VI, HCMF VI ADDITION LIMITED PARTNERSHIP, AND HCMF XV PARTNERSHIP

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No. _____

**IN THE SUPREME COURT OF THE UNITED STATES**

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**HCMF CORP., HERITAGE HALL HOLDING LIMITED PARTNERSHIP, HERITAGE HALL XIII PARTNERSHIP, HCMF PARTNERSHIP VI, HCMF VI ADDITION LIMITED PARTNERSHIP, and HCMF XV PARTNERSHIP,**

***Petitioners,***

**v.**

**CLAUDE A. ALLEN, Secretary of Health and Human Resources; ROBERT W. LAUTERBERG, Director of the Department of Medical Assistance Services, Commonwealth of Virginia; H. ALAN BIGLEY, JR.; DANIEL M. BRODY; LA TISHA OWENS CHATMAN; CATHERINE C. COLGAN; DENICE KING GARNER; STEVEN L. MINTER; JAMES T. PARMALEE, CATHERINE P. SAUNDERS, JAMES R. SMITH; JAMES L. MASLOFF,**

***Respondents,***

**and**

**JAMES GILMORE, The Governor of the Commonwealth of Virginia; THE DEPARTMENT OF MEDICAL ASSISTANCE SERVICES; FRANK MEDICO,**

***Defendants.***

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**ON PETITION FOR A WRIT OF *CERTIORARI* TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT**

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**APPENDIX**

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**APPENDIX**

**ENTERED**
**2-29-00**

**IN THE UNITED STATES DISTRICT COURT**
**FOR THE WESTERN DISTRICT OF VIRGINIA**
**ROANOKE DIVISION**

| | | |
|---|---|---|
| **HCMF CORPORATION, *et al.*** | ) | |
| | ) | |
| **Plaintiffs,** | ) | |
| | ) | |
| **v.** | ) | **Civil Action** |
| | ) | **No. 98-0297-R** |
| | ) | |
| **CLAUDE A. ALLEN, *et al.*** | ) | **Memorandum** |
| | ) | **Opinion** |
| **Defendants.** | ) | |
| | ) | **By: Samuel G.** |
| | ) | **Wilson** |
| | ) | **Chief United** |
| | ) | **States District** |
| | ) | **Judge** |

**CLERK'S OFFICE U.S. DIST. COURT**
**AT ROANOKE, VA**
**FILED**

**FEB 29 2000**

**MORGAN E. SCOTT, JR., CLERK**
**BY: /s/**
**DEPUTY CLERK**

This is an action pursuant to 42 U.S.C. § 1983 by plaintiffs, affiliated owners or operators of seven nursing facilities in Virginia (collectively "Heritage" or the "facilities") against various state officials responsible for administering Virginia's Medicaid program (collectively "Defendants"), to redress alleged federal, statutory, and constitutional violations. In an earlier opinion, the court rejected all of Heritage's claims except a claim that Defendants violated Heritage's fourteenth amendment right to equal protection by classifying without a rational basis "nursing facilities solely on the basis of the financing structure used to construct the nursing facilities." The court noted that absent impermissible motivation the likelihood of Heritage prevailing on what claim was quite small because of the "exceptionally wide latitude afforded the state in drawing economic distinctions." But the court reserved judgment on that claim until the parties had an opportunity to engage in discovery. The case is now before the court on Heritage's motion to amend and on the parties' cross-motions for summary judgment. The court finds that Heritage's proposed amendment would be futile and that Defendants are entitled to summary judgment on Heritage's remaining equal protection claim.

## I.

In 1993, Virginia's Department of Medical Assistance Services ("DMAS") began notifying the seven Heritage nursing care facilities that those facilities had received excess reimbursement for plant costs. DMAS had reimbursed those facilities based on the interest rate on bonds the facilities obtained from local industrial development authorities ("IDA") rather than on their Federal Housing Administration ("FHA") mortgage interest rates. According to DMAS, an earlier review revealed a significant relationship between the facilities' FHA mortgage obligations and the IDA bonds secured by those mortgages.

DMAS claims it discovered that those facilities were able to structure the transactions to retire fully their bond indebtedness before the expiration of their FHA mortgages. Their bond rate, therefore, according to DMAS, more accurately reflected their plant costs. Consequently, DMAS notified the facilities by "Notices of Program Reimbursement" that it would seek reimbursement for excess plant costs claimed through 1993 and would adjust their future reimbursement rates. The nursing home facilities brought suit claiming federal statutory and constitutional violations. The court found for Defendants on all claims except one – the equal protection claim now before the court – and it reserved judgement on that claim in order to have the benefit of a more fully developed factual record.

On the remaining claim, Heritage alleges that Defendants violated the Equal Protection Clause because DMAS's method for reimbursing Heritage's financing costs "classifies [its] nursing facilities solely on the basis of the financing structure used to construct the nursing facilities," (Compl. ¶ 102), and does not consider the legal obligations of the nursing facilities. According to Heritage, "[n]ursing facilities that financed construction using standard FHA-insured mortgages alone are reimbursed by Defendants for interest expense based on the interest rate applicable to the mortgage, for which [those facilities are] legally obligated," (*Id.* at ¶ 103), and "[n]ursing facilities that financed construction using unrated junk bonds are reimbursed by the Defendants for interest expense based on the interest rate applicable to the unrated junk bonds, for which [those facilities are] legally obligated," (*Id.* at ¶ 104). Heritage complains, however, that nursing homes, such as Heritage, "that financed construction using rated, lower interest rate Industrial Development Bonds secured by FHA-insured mortgages, upon which the facilities are legally obligated, are not reimbursed by the Defendants at the interest rate applicable to the mortgage for which [those] facilities are

legally obligated." (*Id.* at ¶ 105.) "Instead, under the Defendants' New Reimbursement Policy, they are reimbursed at the interest rate applicable to the Industrial Development Bonds, despite the fact that the facility is not obligated on the bonds." (*Id.*) Therefore, Heritage claims that Defendants violate the Equal Protection Clause "by applying a reimbursement policy to [Heritage] that is different from the policy applied to nursing facilities that financed construction using standard mortgages or unrated 'junk' bonds." (*Id.* at ¶ 107.) Heritage alleges that "no rational or legal basis exists to support Defendants' discrimination," (*Id.*) and that Defendants "are acting under color of state law in an arbitrary and capricious manner," (*Id.* at ¶ 108).

In response, Defendants assert that their application of reimbursement regulations is supported by a rational basis – "avoid[ing] overpayment, waste, and fraud." (Defs.' Br. Opp'n Pls.' Cross Mot. Summ. J. at 4.) Defendants submitted the deposition and affidavit of James D. Branham, a certified public accountant who DMAS has variously employed as an Audit Supervisor, "Cost Settlement Agent," or "Informal Appeals Agent" since 1987. As an audit supervisor, Branham's responsibilities included "reviewing audits performed by DMAS field auditors to determine whether particular costs – including mortgage and financing costs – submitted by a healthcare provider for reimbursement, were, in fact [sic] reimbursable or allowable under existing principles of Medicaid and Medicare reimbursement." (Branham Aff. at ¶ 3.) Branham discovered in 1989, in reviewing the audit of another nursing home facility with financing arrangements similar to Heritage's, that the payoff of its IDA bonds discharged that facility's mortgage before its stated maturity. Under applicable regulations, DMAS reimburses only necessary interest, and, in Branham's opinion, interest paid directly on the IDA bonds is a more accurate predictor of necessary

interest. (*See* Branham Dep. at 60-75.) He concluded, therefore, that the facility's reimbursable interest rate was the interest rate on its IDA bonds. He later reached the same conclusion when DMAS audited Heritage. His conclusions resulted from a better understanding of the financing arrangements involved, not from a change or a shift in policy. (*See id.* at 109-110.)

DMAS contends, therefore, that its application of regulations is fully justified because it guards against fraud, waste, and abuse. Heritage, however, has submitted the affidavit of a professor of economics, Dr. Leonard G. Schifrin, who has stated that it is his "expert opinion that there is no economic theory that supports the DMAS in its adoption of the bond rate of interest as the surrogate for the actual mortgage rate of interest adjusted for early payoff."

Heritage has moved to amend its complaint, essentially recasting an earlier claim, to include a count alleging that Defendants are violating the reimbursement rate requirements of the Boren Amendment, and both parties have moved for summary judgment on the equal protection claim. This court addresses the motion to amend and the cross motions for summary judgment, in turn.

## II.

Heritage's proposed amendment alleges that "Defendant's [R]eimbursement Policy for HCMF Violates the Reimbursement Rate Requirements Applicable under the Boren Amendment to Nursing Facilities Providing Medical Services to Low-Income Medicaid Recipients in Virginia and [T]hereby [V]iolates 42 U.S.C. 1983." Heritage bases this claim on the recent Ninth Circuit decision Children's Hospital & Health Center v. Belshe, 188 F.3d 1090 (9th Cir. 1999). In that case, the Ninth Circuit held that the repeal of the Boren Amendment did not render moot a challenge to the validity of the Medicaid reimbursement rate methodology

adopted by the California Department of Health Services. *See* 188 F.3d at 1095. The court held that, since California had decided to continue using rates that were set prior to the repeal of the Boren Amendment without subjecting those rates to a public process, California was still required to apply those rate methodologies in a manner consistent with the repealed Boren Amendment. *See* 188 F.3d at 1095. Based on the reasoning of the Ninth Circuit, Heritage asserts that it has a new claim. The court disagrees.

Heritage ignores the fact that the court has already ruled on this question of law and found that no such claim exists. *See* HCMF, 26 F. Supp. 2d at 878-80. As Defendants stated in their memorandum in opposition to Heritage's motion to amend, the plaintiffs' motion "is essentially another request for this Court to reconsider its November 9, 1998 Memorandum Order and Opinion [sic] – dressed up with discussion of the Ninth Circuit's recent decision . . . ." This court specifically addressed the applicability of the Boren Amendment in that opinion:

> With the repeal of the Boren Amendment nothing remains that remotely resembles a federal right to reasonable and adequate rates. There is no federal statutory rate language to parse. There is only a state standard. It follows that there can be no prospective relief under § 1396(a)(13) and that the court must dismiss Heritage's reimbursement claim for lack of federal jurisdiction.

26 F. Supp. 2d at 880. If the Ninth Circuit has held to the contrary, HCMF should take that up in an appeal, not in a motion to amend.[1]

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[1] The court notes that the Third Circuit has since published an opinion agreeing with this court that "Congress has removed a party's ability to enforce a substantive right" with regard to a state's establishment of

HCMF's motion to amend does not assert any new legal theory and, therefore, is futile. Thus, HCMF's motion to amend is denied. *See* Shafer v. Preston Mem'l Hosp. Corp., 107 F.3d 274, 282 (4th Cir. 1997) (holding that, upon conclusion that plaintiff's proposed amendment was futile, district court correctly denied plaintiff's motion to amend); New Beckley Mining Corp. v. Int'l Union, United Mine Workers, 18 F.3d 1161, 1164 (4th Cir. 1994) ("A court may refuse to allow leave to amend when the proposed changes would be futile."); *see also* United States Dev. Corp. v. Peoples Fed'l Sav. & Loan Assoc., 873 F.2d 731, 736 n.4 ("The proper way to handle [last-second amendments alleging meritless claims] is not to allow amendment and then enter summary judgment against the new claim without notice. Rather, a court should deny leave to amend on the grounds of futility.").

## III.

Heritage claims that DMAS's decision in applying the regulations to them violates the Equal Protection Clause of the Fourteenth Amendment and is, therefore, unconstitutional. However, Heritage admits that this application of regulations "concerns 'a type of economic activity that does not impact any suspect or quasi-suspect class or fundamental right.'" (Pls.' Mem. Supp. Cross Mot. Summ. J. at 10 (quoting Smith Setzer & Sons, Inc. v. South Carolina Procurement Review Panel, 20 F.3d 1311, 1320 (4th Cir. 1994)). As such, the decision must be "accorded a strong presumption of validity and must be upheld against an equal protection challenge if there is any reasonably conceivable state of facts that could provide a rational basis for the classification." Plyler v. Moore, 100 F.3d 365, 373 (4th Cir. 1996), *cert. denied*, 520 U.S. 1277 (1997) (quotations and citations omitted). Thus, this court can find

Medicaid reimbursement rates. *See* Children's Seashore House v. Waldman, 197 F.3d 654, 659 (3d Cir. 1999).

an equal protection violation "only if the 'varying treatment of different groups is so unrelated to the achievement of any combination of legitimate purposes' that this court can only conclude that [the defendant's] actions were irrational." Eldridge v. Bouchard, 645 F. Supp. 749, 755 (W.D. Va. 1986) (quoting Vance v. Bradley, 440 U.S. 93, 97 (1979)).

In addition, the burden rests on Heritage to "disprove the existence of 'every conceivable basis which might support [the decision].'" Plyler, 100 F.3d at 373 (quoting Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356, 364 (1973)). "Rational basis review is thus a paradigm of judicial restraint prohibiting [the court] from sitting as a super-legislature to judge the wisdom or desirability of [governmental] policy determinations underlying the [challenged decision]." *Id.* at 373-74 (quotations and citations omitted). "Simply because [Defendants] might have furthered [their] underlying purpose more artfully, more directly or more completely, does not warrant a conclusion that the method it chose is unconstitutional." Eldridge, 645 F. Supp. at 755. Therefore, once the court determines that "a plausible reason exists for the [decision] . . . [the court's] inquiry is at an end." Plyler, 100 F.3d at 374.

Because the parties are cross-moving for summary judgment and both have offered evidence in support of their respective motions, the court must analyze whether either party has met its respective burden of production under Rule 56 as to the policy's rationality or irrationality. If the evidence construed in the light most favorable to Defendants shows that there is no reasonably conceivable rational basis for the reimbursement policy, and the court cannot conceive of a rational basis, then Heritage is entitled to summary judgment. Alternatively, if the evidence, construed in the light most favorable to Heritage, shows that there is a reasonably conceivable rational basis for the policy, then Defendants are entitled to summary judgment. Finally, if the

evidence creates a disputed issue of material fact as to the policy's rationality, then neither party is entitled to summary judgment.

The basic disagreement between the parties is over DMAS's decision to reimburse Heritage based on the interest rate on the IDA bonds instead of the higher mortgage interest rate. Heritage argues that Defendants' decision to use "the bond rate as a surrogate for the adjusted mortgage rate, despite the different capital markets and independent variables," is based on "nothing more than an *ipse dixit* assertion that is itself arbitrary." (Pls.' Mem. Supp. Cross Mot. Summ. J. at 3.) As such, Heritage contends that Defendants "acted arbitrarily and irrationally," and their decision to base reimbursement on the bond rates was, therefore, unconstitutional.

Defendants respond that DMAS acted "to avoid overpayment, waste, and fraud." (Defs.' Br. Opp'n Pls.' Cross Mot. Summ. J. at 2.) Under applicable regulations, DMAS is required to limit reimbursements to necessary interest that is actually incurred. *See* Va. Admin. Code § 30-90-30; Medicare Provider Reimbursement Manual, HCFA Pub. 15-1, ch. 2 secs. 202.1, 202.2 (Dep't Health & Human Services).[2] Based on his experience with similar financing arrangements and his understanding of the regulations, Branham determined that the interest paid on the IDA bonds was a more accurate predictor of necessary interest. When, in his deposition testimony, Branham was asked the basis for the decision to reimburse the bond rate instead of the mortgage rate, he answered:

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[2] Va. Admin. Code § 30-90-20(5) states that Medicare principles of reimbursement set forth in the Medicare Provider Reimbursement Manual shall apply absent a superseding state regulation. The Medicare Provider Reimbursement Manual was attached as Exhibit A to the Plaintiff's Cross-Motion for Summary Judgment.

> It's an application of the regulations. The regulations are in the Medicare Provider Reimbursement Manual which provides for the reimbursement of interest expense incurred. There are several qualifications of necessary and [sic] related to patient care and what not. And we applied those regulations in a reasonable manner to the factual circumstances as we became aware of them. And the facts are that the underlying debt and costs are those of the bonds in that the mortgage note is just an interrelated part of that whole transaction to be a means to secure the bonds and repay the bonds.

(Branham Dep. at 103.) According to Branham, "[t]he system is set up to reimburse the cost incurred," and "what is incurred is the interest on the bonds." (Branham Dep. at 36.) And that, both Branham and Defendants assert, was the basis for DMAS's conclusion that Heritage should be reimbursed at the bond rate instead of the mortgage rate.

Thus, Defendants have provided unrefuted testimony that they decided to reimburse the mortgage rate because they concluded that it more accurately reflected the cost incurred. That decision was based on audit findings and the application of existing regulations. As such, the Defendants contend that the action clearly passes the rational basis test:

> Where as here, the repayment vehicle (the mortgage) carries a higher interest rate than the rate established for repayment of certain IDA bonds issued to finance the construction at issue and provides for a longer term of indebtedness, while simultaneously authorizing and anticipating early mortgage forgiveness upon repayment of the bonds, it is

> reasonable for DMAS to look at the financing arrangement as a whole to determine what the *actual* interest cost will be. In this instance when DMAS did so, it determined that the HCMF facilities' actual interest cost over the term of the financing will parallel the bond rates and not the mortgage rates claimed by HCMF. This finding, even if not mathematically exact, meets the standards articulated by the U.S. Supreme Court in any number of equal protection cases.

(Defs.' Br. Supp. Mot. Summ. J. at 8.) The court agrees.

Although Heritage's numerous briefs raise various issues, they challenge the ultimate effect and wisdom of Defendants' decision, not the claimed basis. Heritage argues that their financing scheme would save the state money and should, therefore, be encouraged. Additionally, Heritage complains that Defendants should have attempted a more exact recalculation of the effect of Heritage's financing arrangement. Moreover, Heritage has submitted the affidavit of an expert witness disagreeing with the economic theory underlying DMAS's decision. Such assertions indicate that Heritage misunderstands the court's role in a non-fundamental rights equal protection claim. It is not the court's role to determine what decision would have been the wisest. Neither is it the court's role to determine whether Defendants' decision was correct or based on an accurate understanding of the facts or economic theory. Instead, the court merely decides whether the decision to reimburse based on the bond rates was "so unrelated to the achievement of any combination of legitimate purposes" as to be "irrational." *See* Eldridge, 645 F. Supp. at 755. If not, the court's inquiry ends. Defendants have presented an unrefuted, plausible reason for the decision. Although Heritage may disagree with that reason and may have valid

normative criticisms of it, the court determines that the evidence, construed in a light most favorable to Heritage, still demonstrates that there was a rational basis underlying the reimbursement decision. Therefore, the court grants Defendants' motion for summary judgment on the remaining equal protection claim and denies Heritage's cross motion.

**IV.**

For the foregoing reasons, Heritage's motions to amend and for summary judgment are denied, and Defendants' motion for summary judgment is granted.

**ENTER**: This 29th day of February, 2000.

/s/ Samuel G. Wilson

CHIEF UNITED STATES DISTRICT JUDGE

**A TRUE COPY *TESTE*:**
**MORGAN E. SCOTT, JR.,**
**CLERK**

**BY: /s/**
**DEPUTY CLERK**

**ENTERED**
**2-29-00**

**IN THE UNITED STATES DISTRICT COURT**
**FOR THE WESTERN DISTRICT OF VIRGINIA**
**ROANOKE DIVISION**

| | | |
|---|---|---|
| **HCMF CORPORATION, *et al.*** | ) | |
| | ) | |
| **Plaintiffs,** | ) | |
| | ) | |
| **v.** | ) | |
| | ) | **Civil Action** |
| | ) | **No. 98-0297-R** |
| | ) | |
| **CLAUDE A. ALLEN, *et al.*** | ) | **FINAL** |
| | ) | **ORDER** |
| **Defendants.** | ) | |
| | ) | **By: Samuel G.** |
| | ) | **Wilson** |
| | ) | **Chief United** |
| | ) | **States District** |
| | ) | **Judge** |

**CLERK'S OFFICE U.S. DIST. COURT**
**AT ROANOKE, VA**
**FILED**

**FEB 29 2000**

**MORGAN E. SCOTT, JR., CLERK**
**BY: /s/**
**DEPUTY CLERK**

In accordance with the Memorandum Opinion and Order entered on November 9, 1998, and the Memorandum

Opinion entered this day, it is hereby **ORDERED** and **ADJUDGED** that:

(1) The plaintiffs' first and second claims are **DISMISSED** for lack of federal jurisdiction;

(2) Judgment for the defendants is **GRANTED** on the plaintiffs' third claim;

(3) The defendants' motion for summary judgment on the plaintiffs' fourth claim is **GRANTED**;

(4) The plaintiffs' motion to amend is **DENIED**; and

(5) This case is stricken from the docket of this court.

**ENTER**: This 29th day of February, 2000.

/s/ Samuel G. Wilson

CHIEF UNITED STATES DISTRICT JUDGE

**A TRUE COPY *TESTE*:**
**MORGAN E. SCOTT, JR.,**
**CLERK**

**BY: /s/**
**DEPUTY CLERK**

**PUBLISHED**

# UNITED STATES COURT OF APPEALS

## FOR THE FOURTH CIRCUIT

| | | |
|---|---|---|
| HCMF CORPORATION; HERITAGE HALL HOLDING LIMITED PARTNERSHIP; HERITAGE HALL XIII PARTNERSHIP; HCMF PARTNERSHIP VI; HCMF VI ADDITION LIMITED PARTNERSHIP; HCMF XV PARTNERSHIP, *Plaintiffs-Appellants*, | ) | |
| v. | ) | |
| CLAUDE A. ALLEN, Secretary of Health and Human Resources; ROBERT W. LAUTERBERG, Director of the Department of Medical Assistance Services, Commonwealth of Virginia; H. ALAN BIGLEY, JR.; DANIEL M. BRODY; LA TISHA OWENS CHATMAN; CATHERINE C. COLGAN; DENICE KING GARNER; STEVEN L. MINTER; JAMES T. PARMELEE; CATHERINE P. SAUNDERS; JAMES R. SMITH; JAMES L. MASLOFF, *Defendants-Appellees*, | ) | No. 00-1360 |
| and | ) | |
| JAMES GILMORE, The Governor of the Commonwealth of Virginia; THE DEPARTMENT OF MEDICAL | ) | |

ASSISTANCE SERVICES; FRANK MEDICO, )
*Defendants.* )

Appeal from the United States District Court
for the Western District of Virginia, at Roanoke.
Samuel G. Wilson, Chief District Judge.
(CA-98-297-7)

Argued: November 1, 2000

Decided: January 23, 2001

Before WIDENER, WILKINS, and NIEMEYER, Circuit Judges

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Affirmed by published opinion. Judge Wilkins wrote the opinion, in which Judge Widener and Judge Niemeyer joined.

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## COUNSEL

**ARGUED:** Earle Duncan Getchell, Jr., MCGUIRE, WOODS, BATTLE & BOOTHE, L.L.P., Richmond, Virginia, for Appellants, Edward Meade Macon, Senior Assistant Attorney General, Richmond, Virginia, for Appellees. **ON BRIEF:** Robert T. Adams, Robert L. Hodges, William H. Baxter, II, MCGUIRE, WOODS, BATTLE & BOOTHE, L.L.P., Richmond, Virginia, for Appellants. Mark L. Earley, Attorney General, William H. Hurd, Solicitor General, Judith Williams Jagdmann, Deputy Attorney General, Gregory E. Lucyk, Assistant Attorney General, Richmond, Virginia, for Appellees.

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## OPINION

WILKINS, Circuit Judge:

HCMF Corporation and several related corporate entities (collectively, "HCMF") brought this action pursuant to 42 U.S.C.A. § 1983 (West Supp. 2000) alleging that the Virginia Department of Medical Assistance Services (DMAS), which administers the Medicaid program in Virginia, violated HCMF's asserted statutory federal right to "reasonable and adequate" rates of reimbursement under the Medicaid program.[1] 42 U.S.C.A. § 1396a(a)(13)(A) (West 1992). After the district court dismissed this claim as barred by the Eleventh Amendment, HCMF moved to amend its complaint to allege a new claim. The district court denied the motion to amend, reasoning that the claim HCMF sought to add to its complaint was indistinct from its original claim, and thus the amendment was futile. Although we conclude that the proposed amendment contained a different claim, we nevertheless agree with the district court that the amendment was futile. Accordingly, we affirm.

### I.

HCMF operates several nursing homes in Virginia. The construction of the nursing homes was financed by bonds authorized by Industrial Development Authorities (IDA). HCMF secured the IDA bonds by obtaining insured mortgages from the U.S. Federal Housing Administration (FHA). The FHA mortgages have a slightly higher interest rate than the IDA bonds.

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[1] The suit named DMAS and several state officials as Defendants. For convenience, we will refer to Defendants collectively as DMAS.

Medicaid is a joint federal-state program under which federal funds are made available to states that provide medical services to eligible recipients. *See* Mowbray v. Kozlowski, 914 F.2d 593, 595 (4th Cir. 1990). Although states that choose to participate must comply with certain federal Medicaid requirements, each state administers its own program. *See* Cabell Huntington Hosp., Inc. v. Shalala, 101 F.3d 984, 986 (4th Cir. 1996).

The federal Medicaid equipment relevant here was contained in the Boren Amendment: Each state was required to assure the federal government that under its Medicaid program the state reimbursed nursing facilities at rates that were "reasonable and adequate." 42 U.S.C.A. § 1396a(a)(13)(A). Congress repealed the Boren Amendment effective October 1, 1997. *See* Balanced Budget Act of 1997, Pub. L. No. 105-33, § 4711, 111 Stat. 251, 507-08 (1997). The new § 1396a(a)(13)(A) contains no substantive mandate; it merely requires that states determine their reimbursement rates via a "public process" that allows providers notice and an opportunity to comment on the proposed rates. See 42 U.S.C.A. § 1396a(a)(13)(A) (West Supp. 2000).

Under the Medicaid program in Virginia, DMAS reimburses nursing facilities that provide care to Medicaid clients for plant costs, including incurred interest costs. *See* 12 Va. Admin. Code 30-90-30(A) (West 2000). DMAS reimbursed HCMF at the FHA mortgage interest rate for several years. In 1997, however, DMAS notified HCMF that henceforth it would reimburse HCMF at the IDA bonds interest rate and that it would seek a refund from HCMF for the years that DMAS reimbursed at the higher, FHA-mortgage interest rate.

HCMF filed this action in May 1998, claiming, as is relevant here, that reimbursement at the bond interest rate

violated the Boren Amendment. The district court dismissed the claim for lack of jurisdiction. The court concluded that the Eleventh Amendment barred any retrospective relief against the state and that no prospective or injunctive relief was possible because Congress repealed the Boren amendment effective October 1, 1997. The court stated that "[w]ith the repeal of the Boren Amendment nothing remains that remotely resembles a federal right to reasonable and adequate rates." HCMF Corp. v. Gilmore, 26 F. Supp. 2d 873, 880 (W.D. Va. 1998).

HCMF moved to amend its complaint to add a new claim based on a December 1997 letter from the United States Health Care Financing Administration (HCFA) that allegedly continued the "reasonable and adequate" standard from the Boren Amendment. In the letter, HCFA opined that "states are not required to subject their existing rates to a public process to the extent that those existing rates were validly determined in accordance with legal standards in effect prior to October 1, 1997." Children's Hosp. & Health Ctr. v. Belshe, 188 F.3d 1090, 1095 (9th Cir. 1999) (internal quotation marks omitted), *cert. denied*, 120 S. Ct. 2197 (2000). HCMF urged that because DMAS had not adopted new rates pursuant to a public process since October 1, 1997, HCFA's letter effectively continued the "reasonable and adequate" standard of the Boren Amendment for DMAS' rates. HCMF alleged that the letter established a "federal policy [that] creates federal rights enforceable" under § 1983. J.A. 237.

The district court denied HCMF's motion to amend. The court reasoned that the proposed amendment asserted no new legal theory, but rather amounted to a request for reconsideration of the dismissal of the previous claim, and that amending the complaint would therefore be futile.

II.

Leave to amend "shall be freely given when justice so requires." Fed. R. Civ. P. 15(a). A motion to amend should be denied "*only when* the amendment would be prejudicial to the opposing party, there has been bad faith on the part of the moving party, or the amendment would be futile." Edwards v. City of Goldsboro, 178 F.3d 231, 242 (4th Cir. 1999) (internal quotation marks omitted). We review the decision of a district court to grant or deny a motion to amend for abuse of discretion. *See id.*

We agree with HCMF's contention that the proposed amendment set forth a new legal theory. HCMF originally claimed that it had a federal right under the Boren Amendment itself for DMAS to pay reasonable and adequate rates of reimbursement. *See* Wilder v. Va. Hosp. Ass'n, 496 U.S. 498, 509-10 (1990) (holding that Boren Amendment created substantive federal right, enforceable by health care providers, to reasonable and adequate rates). In the proposed amendment, HCMF sought to assert that HCFA's letter created a federal right to reasonable and adequate rates of reimbursement. Although both of these claims sought enforcement of the "reasonable and adequate" standard located in the Boren Amendment, the legal theory in the motion to amend was distinct – that a federal policy, rather than a federal statute, created a federal right. Accordingly, the district court was incorrect to consider the amendment merely a restatement of the original claim.

The issue thus becomes whether HCMF's proposed amendment was nevertheless futile.[2] HCMF asserts that the

[2] HCMF contends that if we conclude that the proposed amendment raises a different legal issue than the original claim we must remand the action for the district court to consider in the first instance the merits of the new legal theory. However, the futility *vel non* of HCMF's motion to

claim presented in the proposed amendment was not futile because other federal courts have permitted enforcement of the federal rights provided in the Boren Amendment despite its repeal. *See* Belshe, 188 F.3d at 1095, 1099; Fla. Ass'n of Rehab. Facilities, Inc. v. Fla. Agency for Health Care Admin., 47 F. Supp. 2d 1352, 1357 (S.D. Fla. 1999), *vacated in part sub nom.* Fla. Ass'n of Rehab. Facilities, Inc. v. Fla. Dep't of Health & Rehabilitative Servs., 225 F.3d 1208 (11th Cir. 2000). *But cf.* Children's Seashore House v. Waldman, 197 F.3d 654, 659 (3d Cir. 1999) (holding, without addressing the potential impact of HCFA's letter, that the repeal of the Boren Amendment "removed a party's ability to enforce any substantive right"), *cert. denied*, 120 S. Ct. 2742 (2000). We conclude that HCFA's letter does not have the effect HCMF desires.

In Belshe, the Ninth Circuit held that HCFA's letter authorized the continued application of the Boren Amendment standards, *see* 188 F.3d at 1095, and implicitly concluded that private parties may enforce the HCFA letter in a § 1983 action. We respectfully disagree with the latter conclusion. We have held that a formal regulation cannot by itself give rise to a federal right enforceable under § 1983. *See* Smith v. Kirk, 821 F.2d 980, 984 (4th Cir. 1987); *see also* King v. Town of Hempstead, 161 F.3d 112, 115 (2d Cir. 1998) (*per curiam*) (noting that the circuits are divided on the question of whether a regulation alone can create a federal right). A policy letter has even less legal stature than a regulation. *See* Christensen v. Harris County, 120 S. Ct. 1655, 1662-63 (2000) (holding that agency opinion letters and policy statements, unlike regulations, are not entitled to deference under Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984)). Thus, HCMF's claim is not cognizable regardless of whether the HCFA letter

amend presents a purely legal question which we may now decide. *See* Perry v. Bartlett, 231 F.3d 155, 160 (4th Cir. 2000) (*per curiam*).

properly authorizes the application of Boren Amendment standards to the payments at issue here.

III.

We conclude that the district court erred in treating the claim presented in HCMF's motion to amend as merely a reiteration of the claim the court had previously rejected. However, because we determine that HCMF's motion to amend was futile, we affirm the decision of the district court to deny the motion. In light of this disposition, we express no opinion about the meaning of the HCFA letter or the agency's authority to issue it.[3]

*AFFIRMED*

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[3] HCMF also claimed that DMAS' reimbursement decision violated HCMF's equal protection right because the decision was arbitrary and irrational. The district court granted summary judgment for DMAS on this claim because the court determined that there was a rational basis underlying DMAS' reimbursement decision. *See* HCMF Corp. v. Allen, 85 F. Supp. 2d 643, 648 (W.D. Va. 2000). Having reviewed the parties' briefs and the applicable law, and having had the benefit of oral argument, we affirm this ruling.

December 10, 1997

Dear State Medicaid Director:

This letter is one of a series that provides guidance on the implementation of the Balanced Budget Act of 1997 (BBA). Section 4711 of BBA repeals Sections 1902(a)(13)(A), (B), and (C) of the Social Security Act (the Act), requires states to implement a public process when changes in payment rates or payment methodologies are proposed, and applies to payments for items and services furnished on or after October 1, 1997. (See Enclosure 1 for background on Section 4711.)

Section 4711 of BBA replaced the Boren requirements with a new Section 1902(a)(13)(A) of the Act, which requires states to (a) use a public process for determining rates, (b) publish proposed and final rates, the methodologies underlying the rates, and justifications for the rates, and (c) give interested parties a reasonable opportunity for review and comment on the proposed rates, methodologies, and justifications. In the case of hospitals, such rates must take into account the situation of hospitals which serve a disproportionate number of low-income patients with special needs.

The intent of Section 4711 is to provide states with maximum possible flexibility, as well as to minimize HCFA's role in reviewing inpatient hospital and long-term care state plan amendments involving payment rate changes. HCFA would consider the state to be in compliance with this provision if it elected to use a general administrative process similar to the Federal Administrative Procedures Act that satisfies the requirements for a public process in developing and inviting comment in Section 4711. This will allow states

the flexibility to follow current state public procedures. If a state's public process is not currently being applied to rate setting, or does not currently include a comment period, then the state would need to modify the process. (See Enclosure 2 for public process options.)

The repeal of the Boren amendment cannot be interpreted to be retroactively effective; the Boren amendment still applies to payment for items and services furnished before October 1, 1997. Thus, inpatient hospital and long-term care state plan amendments that are currently pending approval by HCFA, including those where Boren requirement questions are the only outstanding issues, need to have these issues resolved before the amendments can be approved. However, we recognize that the intent in repealing the Boren amendment was to reduce HCFA's role in the institutional payment rate setting process and to increase state latitude in this area. In light of the less restrictive requirements now in place, HCFA is committed to working with states to expedite the resolution of outstanding Boren issues in existing pending amendments.

States that are not proposing changes in their payment methods and standards, or changes in rates for items and services furnished on or after October 1, 1997, need not immediately implement a BA public process. States need only publish proposed rates, methodologies, and justifications prior to the proposed effective date of any changes in payment rates or payment methodologies. In other words, states are not required to subject their existing rates to a public process to the extent that those existing rates were validly determined in accordance with legal standards in effect prior to October 1, 1997. In the event changes are already underway, states are to submit the preprint page (or comparable language inserted elsewhere in the hospital and long-term care payment sections of the plan) with the next proposed amendment. (See Enclosures 3 and 4 for preprint

pages.) We envision a streamlined Federal review process due to the fact that state plan amendments previously submitted under the Boren requirements were subjected to a more rigorous statutory standard both in terms of Federal review of their substance and the review process itself.

Comments or questions regarding this letter may be directed to Marge Lee via e-mail at mlee1@hcfa.gov, or by phone at 410-786-4361. You may also submit them directly to your HCFA regional office contacts. We will all strive to provide you answers in a timely manner.

Sincerely,

# Sally K. Richardson

Sally K. Richardson
Director
Center for Medicaid and State Operations

Enclosures

cc:
Jennifer Baxendell
National Governors' Association

Joy Wilson
National Conference of State Legislatures

Lee Partridge
American Public Welfare Association

All HCFA Regional Administrators

All HCFA Associate Regional Administrators for Medicaid and State Operations